

Under 86 Ill. Adm. Code 140.501(a), where tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, registered servicemen may not claim the Interstate Commerce exemption from Service Occupation Tax. (This is a GIL).

February 26, 2002

Dear Xxxxx:

This letter is in response to your letter dated December 19, 2001. As we stated in our letter to you of October 1, 2001, the Department's regulations regarding Private Letter Rulings provide that "[i]f there is case law or there are regulations dispositive of the subject to the request, the Department will decline to issue a letter ruling on the subject." 86 Ill. Adm. Code 1200.110(a)(3)(D). It is the Department's position that its regulation at 86 Ill. Adm. Code 140.501(a) is dispositive of the subject of your request. Therefore, we are again responding with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

We represent AAA. On behalf of AAA, and under appropriate power of attorney, we hereby submit the enclosed Request for Private Letter Ruling (the '**PLR Request**'). Please process the PLR Request and direct all responses or requests for further information to PERSON or me. Thank you in advance for your attention to this matter.

Your attachment reads as follows:

REQUEST FOR PRIVATE LETTER RULING

In accordance with the Illinois Administrative Code ('**Code**'), the Illinois Department of Revenue ('**IDOR**') will issue Private Letter Rulings ('**PLRs**') in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. 2 IL ADC 1200.110(a). AAA, an Illinois corporation engaged in design and printing services ('**AAA**'), hereby makes the following PLR request ('**PLR Request**').

I. STATEMENT REGARDING PRIOR IDOR RULINGS.

AAA submitted a request for a PLR to the IDOR on August 1, 2001 on an issue related to the subject of this PLR Request. In response, the IDOR issued a General Information Letter dated October 1, 2001 written by Martha P. Mote (the '**GIL**'). General Information

Letters do not constitute statements of IDOR policy, are not binding on the IDOR, may not be relied upon by taxpayers in taking positions with reference to tax issues, and create no rights for taxpayers under the Taxpayers' Bill of Rights Act. 2 IL ADC 1200.120(c). Further, the GIL did not address the specific issue addressed in this PLR Request. Thus, AAA is left without any authority to rely upon in determining which audit (Audit I or Audit II, see below) it should follow in the future.

II. STATEMENT OF FACTS.

One of AAA's primary services is designing and printing catalog order forms and inserts ('Forms') for domestic and foreign companies engaged in retail catalog sales ('Retailers'). In a typical transaction, AAA contracts directly with a Retailer to design and print the Forms that are inserted in their catalogs. AAA takes these orders and designs and prints the Forms at its offices in CITY, Illinois. Large catalog producers, binderies or fulfillment houses ('Producers') print the catalogs. AAA delivers the completed Forms directly to the Producer to be inserted in the catalogs and distributed nation-wide via United States Mail.

AAA has been the subject of two recent audits by the IDOR, one in 1997 and another in 2000. The first took place on or about January 15, 1997 when PERSON2, representing the IDOR, completed a Sales and Use Tax Audit of AAA ('Audit I'). PERSON2 determined that AAA was liable for sales tax based on the gross receipts received by AAA only from the portion of the Forms that were ultimately distributed in catalogs in Illinois. The Forms that remained in Illinois were estimated at 5%¹ of the total; thus, AAA was liable for sales tax based on 5% of the selling price of the total tangible personal property.

The second took place on or about March 20, 2000 when PERSON3, representing the IDOR, completed a Sales and Use Tax Audit of AAA ("Audit II"). Apparently, PERSON3 believed that Audit I was incorrect, because he determined that AAA was liable for sales tax based on the gross receipts received by AAA from all of the Forms sold to Retailers and delivered to Illinois Producers, whether such Forms were ultimately distributed in Illinois or not.

III. REQUEST.

AAA has received conflicting oral reports from the IDOR with respect to its sales tax liability on one of its primary services. Taxpayers cannot rely on verbal opinions from IDOR employees but will be protected only if the opinion from the IDOR is in writing. 86 IL ADC 140.901(a). These conflicting audit results create uncertainty regarding AAA's sales tax liability. The GIL was issued because there is a provision in the Code dispositive of the subject of the GIL. See GIL, Page 1. However, the GIL did not give AAA any guidance on which audit (Audit I or Audit II) conforms to the provision in the Code that is dispositive. Thus, in order to comply with Illinois' sales tax laws, AAA must now submit this PLR Request. Specifically, should AAA comply with the findings in Audit I or Audit II?

IV. ARGUMENTS.

A. IDOR Position.

The IDOR relies on 86 IL ADC 140.501(a) as dispositive of the issues raised in the GIL. See GIL, Page 8. The relevant section of that regulation, quoted in the GIL, provides that:

‘[w]here tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, the serviceman incurs Service Occupation Tax liability on the selling price of the property. The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of such property in this State. This is so notwithstanding the fact that the purchase may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce.’

That provision, as written today and as relied upon by the IDOR, has been in effect since January 1, 1990. Thus, both PERSON2 and PERSON3 were interpreting that provision when completing their respective audits. Since they came to different conclusions, it follows that the regulation leaves open to interpretation whether the ‘**5% Rule**’ applied in Audit I is proper.

B. Interstate Commerce Exemption.

The 5% Rule in Audit I conforms to economic reality. An exemption exists that avoids all liability under the Service Occupation Tax for Forms shipped outside of Illinois. A Serviceman does not incur Service Occupation Tax liability on property sold as an incident to a sale of service under an agreement by which the Serviceman is obligated to make physical delivery of the goods from a point in Illinois to a point outside of Illinois. 86 IL ADC 140.501(b). To qualify for this exemption, the property must not be returned to Illinois and the shipment contemplated must actually occur. Id. Such delivery may be made by the Serviceman, by carrier or through the mail. Id. Sales of service of this type are deemed to be within the protection of the Commerce Clause of the Constitution of the United States. Id.

Except for a small portion of the Forms distributed in Illinois, estimated at 5% by PERSON2, AAA contracts directly with Retailers to ship the Forms to Producers to be distributed outside of Illinois. The Forms are sent nation-wide through the United States Mail without the Retailer ever coming into physical possession of the Forms. While it is true that the Forms are first shipped to a Producer in Illinois to be included in catalogs, this additional stop is temporary and should be disregarded for purposes of the Service Occupation Tax Act. The economic reality is that AAA is shipping its products out-of-state, except for that small portion that is ultimately distributed within Illinois.² It just so happens that the Forms, on their way out-of-state, are momentarily routed through an Illinois distribution point. Indeed, if AAA itself provided the incidental service provided by the Producers, there would be no Service Occupation Tax liability for AAA. This is the conclusion reached in Audit I, and it is correct.

Nor should the conclusion reached in Audit I be affected by Deere & Co. v. Allphin, 346 N.E. 2d 117 (Ill. App. 3d Dist. 1977). In that case, the plaintiffs (a retailer and a printer, both located in Illinois) brought suit against the IDOR claiming they were not liable for Illinois sales tax. Id. Although the Deere court ultimately held that the plaintiffs were

liable for sales tax, Deere is distinguishable from AAA's transaction and does not address the Equal Protection issues discussed in Section C below.

The Deere court held that the plaintiffs could not use the interstate commerce exemption for two reasons. First, the exemption only applies to products that are sold. Id. Since the plaintiffs were distributing marketing materials for no charge, the court felt that the transaction was more in the nature of a gift than a sale. Id. Here, on the other hand, AAA is paid for and thus sells the Forms which it designs and prints. Therefore, AAA, unlike the Deere plaintiffs, satisfies the 'sale requirement' of the exemption.

Second, the Deere court held that the exemption did not apply there because some of the property sent out-of-state by the plaintiffs was ultimately meant to be returned to Illinois. The exemption, however, does not require that *all of the property transferred* in a particular transaction stay outside of Illinois. It merely requires that the out-of-state shipment must actually occur and *the property not subject to the tax* must stay outside of Illinois. Id. Any attempt to impose a different standard would be meaningless as it is easy to create different orders for property known to stay outside of Illinois and another for the portion ultimately returned. AAA is not seeking an exemption for all of the property they sell incident to providing services, but only for that portion shipped outside of Illinois and *not returned*.

C. Equal Protection.

The 5% Rule in Audit I relieves discrimination against Illinois residents in favor of nonresidents. The application of Audit II conflicts with the Equal Protection Clause. The Equal Protection Clause of the Constitution of the State of Illinois states that no person shall be denied equal protection of the laws. Ill. Const. Art. I, Sec. 2. The Equal Protection Clause guarantees that those similarly situated will be dealt with in a similar manner. East St. Louis Fed. of Teachers. Local 1220 v. East St. Louis Sch. Dist. No.189, 687 N.E.2d 1050 (Ill. 1997). Illinois' sales tax treats similarly situated taxpayers in a substantially different manner. The flat taxes imposed by the sales tax discriminate **against** Illinois residents in favor of nonresidents.

If neither the exemption discussed in Section B above nor the 5% Rule applies to AAA, then AAA, with a clear nexus to Illinois, is liable for the Service Occupation Tax. A printer from another state, however, with no other nexus to Illinois, would not be liable for the Service Occupation Tax even if it sent its products to Producers in Illinois like AAA does. This is because Illinois would have no authority to tax such an entity. Such sales would also be exempt from the Service Use Tax due to their 'temporary use' in Illinois. 86 IL ADC 160.110. No Service Use Tax is imposed on a use in Illinois of property acquired outside of Illinois that is temporarily brought to Illinois to be physically attached or incorporated into other property that is ultimately used outside of Illinois. Id. This creates a substantial incentive for Illinois Retailers to contract with printers outside of Illinois. Similarly, when Retailers contract directly with a Producer to design and print the catalogs and the Forms, no Service Occupation Tax is paid on the value of the catalogs and Forms sent outside of Illinois. This results in discrimination against Illinois residents in favor of nonresidents, unless either the exemption discussed in Section B above or the 5% Rule applies to the Illinois resident.

V. STATEMENT REGARDING PENDING AUDITS AND LITIGATION.

To the best knowledge of both AAA and AAA's representative, no audit or litigation is currently pending between the IDOR and AAA.

VI. IDENTIFICATION OF TRADE SECRET INFORMATION.

There is no trade secret information that should be deleted from the publicly disseminated version of this PLR Request, except for the name and address of AAA and AAA's representative.

Submitted on December 19, 2001 by FIRM, an Illinois corporation, on behalf of AAA, under appropriate power of attorney attached hereto.

The Department's regulation at 86 Ill. Adm. Code 140.501(b) provides that "[t]he serviceman does not incur Service Occupation Tax liability on property which he resells as an incident to a sale of service under an agreement by which the serviceman is obligated to make physical delivery of the goods from a point in this State to a point outside this State, not to be returned to a point within this State, provided that such delivery is actually made. Nor does the tax apply to property which the serviceman resells as an incident to a sale of service under an agreement by which the serviceman, by carrier (when the carrier is not also the purchaser) or by mail, delivers the property from a point in this State to a point outside this State, not to be returned to a point within this State. The place at which title to the property passes to the purchaser is immaterial. The place at which the contract of sale of the service or contract to sell the service is negotiated and executed and the place at which the purchaser resides are also immaterial. Sales of service of the type described in this paragraph are deemed to be within the protection of the Commerce Clause of the Constitution of the United States."

However, 86 Ill. Adm. Code 140.501(a) provides that "[w]here tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, the serviceman incurs Service Occupation Tax liability on the selling price of the property. The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of such property in this State. This is so notwithstanding the fact that the purchaser may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce."

It is our understanding that AAA contracts with retailers to design and print forms to be inserted into the retailers' catalogs. AAA performs the design and print work at its offices in CITY, Illinois. It then delivers the forms to the retailers' producers in Illinois. The producers insert the forms into catalogs and then distribute the catalogs nationwide.

Assuming that all the facts regarding AAA's delivery of forms to the producers in Illinois are the same for Audit I and Audit II, it is the Department's position that the regulation was correctly applied in Audit II. This is because AAA makes delivery of the forms to the retailers' producers in Illinois. Under Section 140.501(a), it does not matter that the producers will subsequently distribute the catalogs outside the State. AAA's deliveries are made in Illinois, and the Department has no authority to disregard this temporary stop in Illinois.

The result would be different, if, as you mentioned, AAA itself made the deliveries out of State. Such an arrangement would be covered by Section 140.501(b).

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

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Enc.

¹ The 5% figured used by PERSON2 is derived from 1990 United States Census figures representing the population of Illinois compared to the population of the United State.

² Presumably, the current percentage of Forms deemed to be distributed in Illinois should relate to available 2000 United States Census figures representing the population of Illinois compared to the population of the United States.